09/22/2017

VIA ELECTRONIC SUBMISSION

Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions
cpmi@bis.org and CCP-SST@iosco.org

Re: Cover note to the consultative report on the *Framework for supervisory stress testing of central counterparties (CCPs)*

To Whom It May Concern:

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Committee on Payments and Market Infrastructures ("CPMI") and the International Organization of Securities Commissions' ("IOSCO") consultative report on the *Framework for supervisory stress testing of central counterparties (CCPs)* ("the Consultative Report").[1]

CME Group is the parent company of four designated contract markets ("DCMs"): Chicago Mercantile Exchange Inc. ("CME Inc."), the Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), and Commodity Exchange, Inc. ("COMEX"). These DCMs offer the widest range of benchmark products available across all major asset classes, including futures and options on futures based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural, and commodities products. CME Inc. operates a clearing house, registered as a derivatives clearing organization ("DCO") with the U.S. Commodity Futures Trading Commission ("CFTC"), which offers clearing and settlement services for exchange-traded derivatives contracts and cleared swap derivatives transactions. In respect of its clearing operations, CME Inc. has been deemed a systemically important financial market utility by the U.S. Financial Stability Oversight Council ("FSOC").

CME Group appreciates CPMI-IOSCO's work to establish a supervisory stress test ("SST") framework that focuses on assessing the macro-level impacts of a stress event on central counterparties ("CCPs") and the markets they serve. CME Group believes this work will supplement CPMI-IOSCO's continuous efforts to promote financial stability. We believe the high-level framework that has been proposed under the Consultative Report provides the appropriate level of flexibility for authorities to design SSTs that recognize the different markets

[1] Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, *Consultative report, Framework for supervisory stress testing of central counterparties (CCPs)* [hereafter *Consultative Report*] (Jun. 2017).

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and participants CCPs' serve. A CCP's participation in an SST should be initiated by its primary regulator and all communication should be between the CCP and its primary regulator.

Below are CME Group's comments as they relate to the questions contained in the cover note to the Consultative Report.

Consultative Report Questions & CME Group Responses

1. Objective and purposes of multi-CCP tests (see Introduction and Element 1.i)

> *a. Is the framework clear with regard to the objective that a multi-CCP SST is intended to achieve, specifically to analyse the broad, macro-level impact of a common stress event on a set of CCPs?*
>
> *b. Do potential users of the framework consider that its structure and content, including the design tool in Annex A, are adequate to facilitate and support them in designing and running a multi-CCP SST to meet the stated objective?*
>
> *c. Do potential users of the framework consider that it is sufficiently flexible to accommodate different authorities with varying responsibilities, legal frameworks, expertise and resources?*
>
> *d. What do stakeholders consider to be the benefits or other implications from a multi-CCP SST?*
>
> *e. Remaining cognisant of confidentiality concerns and the potential need for aggregation and anonymisation of test results, how do stakeholders anticipate using the results of SST exercises?*

The goal of the SST framework to analyze the broad, macro-level impact of common stress events on a set of CCPs is clear. We believe the proposed SST framework appropriately leverages the unique position of regulators to assess stability across a set of CCPs and markets on a macro-level. CCPs, while the foremost experts on the markets they clear, do not have visibility across other areas of the financial markets and these tests will allow CCPs to combine their understanding of their markets with insight into the risks that their participants bring to the broader financial ecosystem. The Consultative Report appropriately recognizes that a given stress scenario will not impact all CCPs equally which can make comparisons across CCPs, in light of the variety of markets they clear, meaningless. Therefore, it is entirely appropriate for a multi-CCP SST to assess macro-level impacts which allow authorities to address broader financial market stability. The results of the SST should allow market stakeholders to assess the resiliency of the financial system by evaluating the potential aggregate net shortfalls across the in-scope CCPs' clearing members on an anonymized basis, as well as on an anonymized basis the direction of clearing members' shortfalls for a single given scenario for each of the in-scope CCPs (i.e., a clearing member has a loss at one CCP, but a gain at the other).

2. Scope and frequency of SST exercises (see Element 1.ii, iii)

> *a. How can the authorities best strike a balance between the usefulness of SST results and the potential resource burdens and costs to themselves, CCPs and other stakeholders associated with conducting a SST exercise?*
>
> *In particular:*
>
> > *i. What would be an appropriate frequency for conducting SSTs?*
> >
> > *ii. Would the use of multiple reference dates sufficiently increase the information provided by a SST exercise to justify a higher resource cost?*

Coordination among authorities, clear templates and communication protocols with CCPs, and engagement with impacted market stakeholders are critical to reduce the resource burden of CCP participation in an SST. Additionally, in order to limit resource constraints and ensure that the exposures being evaluated are sufficiently distinct in light of the portfolios of market participants and the open interest at the CCP, an SST should be conducted no more frequently than annually.

3. Involvement of CCPs and other stakeholders (see Element 1.iv; Element 2.i, ii)

a. What level of engagement would CCPs and other stakeholders expect to have in the design of an SST exercise? Please explain whether the level of engagement is likely to depend on the particular purpose or design of the SST. How might stakeholder feedback best be sought?

b. Which roles and responsibilities should CCPs assume – or would CCPs expect to assume – in the design and running of an SST?

c. What safeguards would ensure that the independence of an SST as a supervisory exercise is maintained?

Any final guidance in regards to a framework for SSTs should require authorities to consider the input of CCPs throughout the process. CCPs are the foremost experts in the markets they clear and can provide essential input into the design of the SST (i.e., identification of risk exposures and calibration of stress scenarios, including plausibility of scenarios). CCPs are best suited to opine on the unique practices that they apply as part of their internal stress testing frameworks and the way that authorities should design the suite of stresses utilized as part of the SST to appropriately test the resiliency of their markets. The strong understanding that CCPs have of their internal stress testing practices and the related risk exposures can be leveraged by authorities in designing an extreme but plausible SST. Input from CCPs on both stress testing practices they currently employ and characteristics, including vulnerabilities of the markets they clear will yield an SST that is credible and appropriately captures extreme but plausible market conditions.

In line with the Consultative Report, CME Group agrees that input from market stakeholders, CCPs or otherwise should not undermine the independency of the SST and its results. Authorities should ultimately be responsible for selecting the risk factors and sources to be assessed in the SST while relying on the guidance of CCPs. Of course, the authorities should not merely duplicate the full suite of the in-scope CCPs' internal stress testing scenarios but rather create well-grounded stress scenarios that test the resiliency of the financial markets across the CCPs. We are pleased that a variety of CCPs' market participants have been given the opportunity to weigh-in on the proposed SST framework; however, we note that a similar level of engagement by entities not subject to the stress tests is not common across the stress testing regimes for financial institutions. Therefore, we believe the primary point of engagement for feedback on the structure and design of an SST should be the in-scope CCPs.

4. Information-sharing, data collection and data protection (see Element 2.iii, Component 4)

a. Do stakeholders perceive any legal or operational constraints on sharing the (individual/named) data required to support an SST exercise? Please describe.

b. What arrangements do stakeholders consider could be put in place to enhance the effectiveness of data collection and to promote the quality and consistency of data? What are the potential limitations?
c. What assurances would stakeholders seek if their data were to be used in an SST exercise?
d. What data protections and safeguards should the authorities put in place?
e. The framework anticipates that CCPs will be a primary source of data for many SSTs. Is this an accurate assumption? Do stakeholders agree that this approach is generally likely to be most efficient from an operational and confidentiality perspective? Are there other potential sources of data? If so, what other data sources could be relevant for conducting an SST and what guidance would be useful to provide to authorities?

CME Group appreciates CPMI-IOSCO's focus on information sharing, data collection, and data protection. It is critical that authorities conducting an SST prioritize ensuring the confidentiality of data for CCPs and their market participants. In particular, the Consultative Report rightfully recognizes the data privacy challenges of conducting a cross-jurisdictional SST and the importance of having information sharing agreements in place to conduct such SST. The authorities conducting the cross-jurisdictional SST must ensure the necessary arrangements are in place to protect the confidentiality of data. Additionally, where the CCP is the data source, it should be the home (primary) regulatory authority who requests the data from the CCP, shares appropriately anonymized data with its fellow authorities engaged in the SST, and engages with market participants to ensure they have a clear understanding of the protections in place to maintain confidentiality.[2] It is also critical that authorities provide a clear and concise standardized template for information production to increase consistency and reduce the likelihood of production or transcription issues.

5. Technical content of the framework (see Components 3 and 5)

a. Do stakeholders have any comments on the technical content of the framework, including but not limited to the guidance on setting extreme but plausible scenarios, identifying core risk factors, calibrating shocks, extrapolation, identifying defaults/failures, aggregation procedures and metrics?
b. In designing an SST, what should authorities consider when determining which risk sources and risk exposures to include? How can authorities balance the need for sufficient content with burden?
c. In designing an SST, authorities may (need to) make design choices that differ from the expectations set forth in the PFMI and further guidance on stress testing practices by individual CCPs. Do CCPs foresee issues if authorities proceed in a manner that differs from approaches taken by individual CCPs in their own stress tests? What trade-offs would the authorities need to assess when making those design choices?
d. What is an appropriate number of scenarios to include in an SST? What factors should authorities consider when determining the number of scenarios to apply?

In designing an SST, authorities must ensure that the scenarios utilized meet the extreme but plausible test. Due to the macro-level approach being proposed by CPMI-IOSCO, we believe that a narrative explanation of the scenario being utilized (rather than simply providing shocks without context) will help ground an SST in plausibility. In addition, a narrative explanation of the

[2] We note that the regulatory authority may also be the source of data for an SST.

events leading to the shocks will allow for an understanding of extreme but plausible nature of the stress scenarios. This approach allows authorities conducting an SST to balance the need for sufficient content that is useful to market stakeholders with the burden of actually conducting the SST.

CME Group recognizes the benefits of any final guidance on an SST framework working cohesively with the *Principles for financial market infrastructures* ("PFMIs")[3] and the final report on the *Resilience of central counterparties (CCPs): Further guidance on the PFMI* ("PFMI Additional Guidance")[4], but at the same time believes it is critical that an SST account for the markets and market structure in which the in-scope CCPs operate. By way of example, liquidity stress tests must normalize differences between the definitions of qualifying liquidity resources across jurisdictions while assumptions regarding client payments and porting should account for the risk management standards and porting flexibility of different jurisdictions. We address the potential implications of failing to account for differing market structure in more detail below.

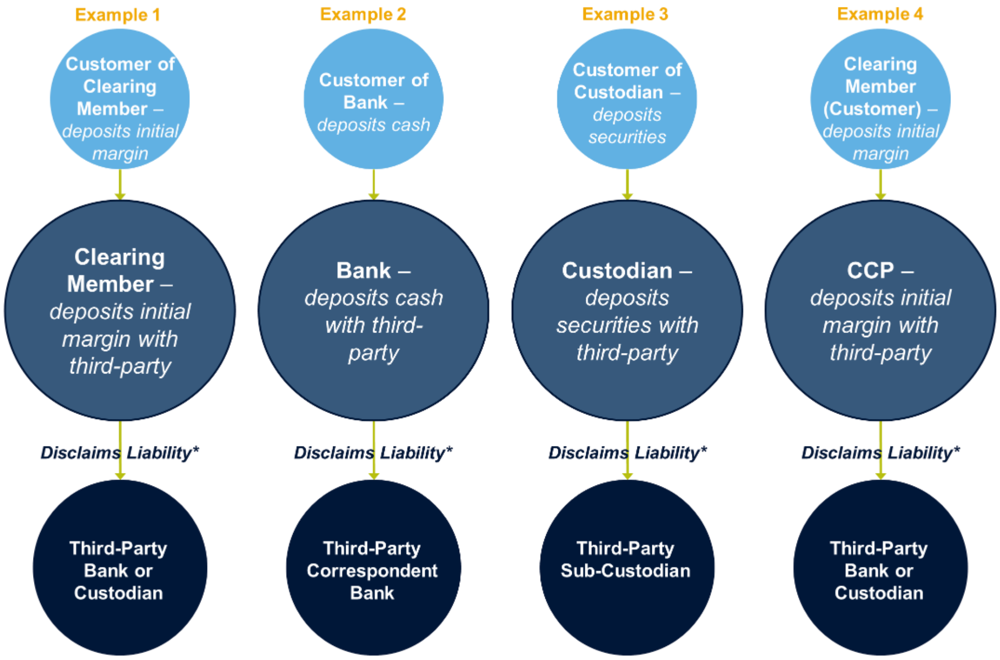
Settlement Bank and Custodian Failure

CME Group does not believe the inclusion of scenarios that assess the failure of settlement banks or custodians are extreme but plausible, and given the unreasonableness of such scenarios, the results of an SST focusing on these failures would provide limited risk management benefits to market stakeholders.

The structure of the bank supervisory regime in the U.S. and for global systemically important banks is designed to manage failures in a manner that avoids a loss to depositors and/or a loss to custody assets and access to them. Even though there is a remote possibility of the failure of appropriately regulated banks and custodians occurring, the role of a derivatives CCP is not to guarantee the performance of the financial system, but to guarantee the financial performance of derivatives exposures for the markets it clears. A CCP's use of third-party banks and depository institutions to deposit collateral is virtually identical to a clearing member's use of them. CCPs and their clearing members both collect initial margin to collateralize exposures to their counterparties. In the case of a CCP, exposure to its clearing members, and in the case of a clearing member, exposure to its customers. Further, a CCP's use of banks and custodians is analogous to a bank using third-party correspondent banks and a custodian using third-party sub-custodians. Financial industry practice is for clearing members to disclaim losses to their customers arising from a third-party bank or depository failure. Banks take the same approach for third-party correspondent banks, as do custodians for third-party sub-custodians. **Figure 1** confirms this point by illustrating industry practice in loss acceptance for the failure of third-party banks and custodians.

[3] Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (Apr. 2017) (noting the Committee on Payments and Market Infrastructures was formerly known as the Committee on Payment and Settlement Systems).
[4] Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, *Final report, Resilience of central counterparties (CCPs): Further guidance on the PFMI* (Jul. 2017).

Figure 1



***Indicates that the entity initially accepting the cash or securities collateral disclaims liability to the depositor for the failure of the third-party service provider.**

An SST implying a CCP should bear the losses for the failure of a settlement bank or custodian would make CCPs the only link in the chain that accepts responsibility for third-party banking and depository risk losses. This imposition does not conform with market convention and would require CCPs to guarantee ancillary parts of the financial system. An SST that implies are CCP is responsible for bearing these losses effectively requires CCPs to become insurers with unlimited, or at a minimum, significant liability for third-party entities providing banking services even though the entities providing these banking services do not accept a similar level of liability for their core service offering. Therefore, it would be inappropriate and without precedent to have an SST that implies a CCP should be responsible for the losses from a settlement bank or custodian failure because such an SST would effectively result in an assumption that CCPs act as guarantors for the banking and custodial ecosystem. A CCP cannot and should not be expected to guarantee idiosyncratic losses or disruptions stemming from the failure of a settlement bank or custodian.

Client Exposures

The Consultative Report implies that in developing an SST it should assume a ‘cover all’ client scenario due to a CCP’s inability to port customers of a defaulting clearing member. This assumption does not account for differing regulatory frameworks and more specifically, customer margining practices. For example, the U.S. regulatory construct supports bulk porting of client accounts in the event of a clearing member default, greatly increasing the likelihood that client accounts can be successfully transferred rather than liquidated. The likelihood of successful porting is further reinforced with a customer gross margining regime, which is required under U.S. regulations. Customer gross margining significantly increases the likelihood that clients are fully margined at the time of porting and that either the entirety or smaller subsections of the customer pool can be easily transferred to one or multiple non-defaulting clearing members, respectively. Conversely, customers margined on a net basis must be ported together or risk being significantly under margined at the time of transfer since there is only enough margin to meet the net obligations of all clients combined in one portfolio. In such a regime, if one clearing member is not able or willing to accept the entire client book the CCP's options are either procyclical initial margin calls on clients or the liquidation of their positions. In the U.S., CCPs have successfully ported customer positions of insolvent clearing members.

We encourage CPMI-IOSCO to revisit this piece of the proposed guidance in the Consultative Report to consider the plausibility of customer porting with respect to the regulatory structure in different jurisdictions when designing an SST.

Treatment of Resources

Although the scenarios and related risk sources and risk exposures they are designed to capture are key to ensuring an SST is representative of extreme but plausible market conditions, it is equally important that the application of financial or liquidity resources under the stress event is consistent with what would occur. This is of particular importance in a cross-jurisdictional SST where CCPs are subject to varying regulatory requirements, which influence their ability to use their resources to manage a stress event. For example, under EU regulations a CCP can utilize non-defaulting clearing members' initial margin funds as a liquidity resource, whereas in the U.S. this practice is not permitted. Therefore, it is critical that when evaluating the impact to resources as a result of a stress event, the treatment of resources is consistent with the regulatory requirements for which the each of the in-scope CCPs is subject and of course, the relevant rules in the each of the CCPs' rulebooks.

6. Use of SST results and disclosure (see Component 6)

> *a. Do stakeholders have views on disclosure of the results of an SST? Are there circumstances in which results should not be disclosed publicly?*
> *b. Remaining cognisant of confidentiality concerns and the potential need for aggregation and anonymisation of the results, what types of disclosure would stakeholders find most useful?*

Appropriate disclosure of SST results is critical and regulators must consider the potential risks of over-disclosure including the impacts to market participant confidentiality. As CPMI-IOSCO recognizes in the Consultative Report, one of the most important considerations in determining the appropriate level of disclosures for an SST's results is how to best protect the confidentiality of the portfolios of a CCP's market participants. To ensure the protection of market participants and the integrity of the market, disclosures should not allow clearing members' portfolios to be reverse engineered.

Authorities conducting an SST must be transparent, on an *ex ante* basis, in regards to the objective of the SST and its design. In regards to disclosure of the outcomes of the results of the SST, CME Group believes the level of disclosure provided by individual CCP regulators that have conducted SSTs in the past serve as a valuable model. In particular, the information provided by the CFTC in its November 2016 report of the *Supervisory Stress Test of Clearinghouses* ("the Report")[5] provides a helpful model for disclosure. The Report provides

[5] Commodity Futures Trading Commission, *Supervisory Stress Test of Clearinghouses* (Nov. 2016), *available at:* http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/cftcstresstest111516.pdf.

valuable information on the level of coverage across CCPs, the types of stress scenarios used, and the diversification of risk across CCPs. This information allows market participants to evaluate the impacts of certain stress tests on a variety of CCPs representing a large portion of the markets for which they clear without risking disclosure of confidential information.

As noted in our responses for Element 1, an SST's disclosure of results could include on an anonymized basis the aggregate net shortfalls across the in-scope CCPs' clearing members, as well as on an anonymized basis the direction of clearing members' shortfalls for a single given scenario across all the in-scope CCPs. A SST's disclosures could also show the number of maximum clearing member shortfalls across the scenarios used. Another disclosure for an SST that would enhance stakeholders' visibility into the resiliency of the industry is disclosing on an anonymized basis the largest single clearing member shortfall at each of the in-scope CCPs and the related remaining default fund collateral of those clearing members at the other in-scope CCPs.[6] These disclosures would allow stakeholders to assess the diversity of exposures across the in-scope CCPs and more granularly how a loss of a clearing member at one CCP under a given scenario may be hedged against exposures that are gaining at other CCPs.

Conclusion

CME Group appreciates the goals of CPMI-IOSCO's Consultative Report and more broadly, its ongoing work to foster financial stability. We would be happy to further discuss and clarify any of the above comments with CPMI-IOSCO. If any comments or questions regarding this submission arise, please feel free to contact Sunil Cutinho, President, CME Clearing at +1 312 634-1592 and sunil.cutinho@cmegroup.com.

Sincerely,

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[6] For example, this could entail disclosing the largest single clearing member shortfall under a given scenario at one CCP and under the same scenario, the remaining default fund collateral of that clearing member at the other in-scope CCPs. This disclosure would be duplicated for each of the in-scope CCPs.